



Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change to Amend Rule 2165 (Financial Exploitation of Specified Adults)

September 22, 2021.

I. Introduction

On June 9, 2021, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change SR-FINRA-2021-016 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder² to amend FINRA Rule 2165 (Financial Exploitation of Specified Adults) to: (1) permit member firms to place a temporary hold on a securities transaction, subject to the same terms and restrictions applicable to a temporary hold on disbursements of funds or securities (“disbursements”), where there is a reasonable belief of financial exploitation of a “specified adult” as defined in the rule;³ (2) permit member firms to extend a temporary hold, whether on a disbursement or a transaction, for an additional 30 business days if the member firm has reported the matter to a state regulator or agency or a court of competent jurisdiction; and (3) require member firms to retain records of the reason and support for any extension of any temporary hold, including information regarding any communications with, or by, a state regulator or agency of competent jurisdiction or a court of competent jurisdiction. The proposed rule change was published for comment in the Federal Register on June 28, 2021.⁴ On July 20, 2021, FINRA consented to extend until September 24, 2021, the time period in which the Commission must approve the proposed rule change,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See infra note 9 and accompanying text.

⁴ See Exchange Act Release No. 92225 (Jun. 22, 2021), 86 FR 34084 (Jun. 28, 2021) (File No. SR-FINRA-2021-016) (“Notice”).

disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.⁵ On August 23, 2021, FINRA responded to the comment letters received in response to the Notice.⁶

The Commission is publishing this order pursuant to Section 19(b)(2)(B) of the Exchange Act⁷ to solicit comments on the proposed rule change from interested persons and to institute proceedings to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

Background

FINRA's proposed rule change would amend Rule 2165, which currently permits a member firm to place a temporary hold on a disbursement from the account of a "specified adult" customer for up to 25 business days if the criteria of the rule are satisfied.⁸ A "specified adult" is someone either age 65 and older, or age 18 and older if the member firm reasonably believes that a mental or physical impairment has rendered the person incapable of protecting their own interests.⁹ According to FINRA, temporary holds on disbursements have played a

⁵ See letter from Jeanette Wingler, Associate General Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel – Sales Practices, Division of Trading and Markets, Commission, dated July 20, 2021. This letter is available at <https://www.finra.org/sites/default/files/2021-07/SR-FINRA-2021-016-Extension1.pdf>.

⁶ See letter from Jeanette Wingler, Associate General Counsel, FINRA, to Vanessa Countryman, Secretary, Commission dated August 23, 2021 ("FINRA Letter"). The FINRA Letter is available at the Commission's website at <https://www.sec.gov/comments/sr-finra-2021-016/srfinra2021016-9160159-247786.pdf>.

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ See infra for a discussion of existing safeguards incorporated into Rule 2165.

⁹ See Rule 2165(a)(1). Supplementary Material .03 to Rule 2165 provides that a member firm's reasonable belief that a natural person age 18 and older has a mental or physical impairment that renders the individual unable to protect their own interests may be based on the facts and circumstances observed in the member firm's business relationship with the person. See Notice at 34086 n.17.

significant role in providing member firms with a way to respond promptly to suspicions of customer financial exploitation before a customer experiences potentially significant losses.¹⁰

A member firm's ability to place a temporary hold on disbursements is subject to a number of conditions that are designed to help prevent misapplication of the rule.¹¹ These safeguards would apply equally to the proposed rule change permitting temporary holds on transactions. The safeguards include requiring that member firms provide notification of both the hold, and the reason for the hold, to all parties authorized to transact business on the customer's account, including the customer and a trusted contact person of the customer, no later than two business days after the day on which the firm first placed the hold.¹² Temporary holds may only be placed based on a member's reasonable belief of financial exploitation—for example, a customer payment related to a commonly known scam, such as a lottery scam.¹³

Once the temporary hold has been placed, the member firm must immediately initiate an internal review of the facts and circumstances that caused the firm to reasonably believe that the financial exploitation of the specified adult has occurred, is occurring, has been attempted, or will be attempted.¹⁴ Furthermore, the general supervisory and recordkeeping requirements of certain FINRA rules¹⁵ require a member firm relying on Rule 2165 to establish and maintain written supervisory procedures that are reasonably designed to achieve compliance with the rule, including, but not limited to, procedures related to the identification, escalation, and reporting of

¹⁰ See Notice at 34086. For example, according to FINRA member firms have placed temporary holds to prevent senior investors from losing: (1) \$200,000 (representing approximately two-thirds of the investor's account) related to a lawsuit scam; (2) \$10,000 in a lottery scam; (3) \$60,000 in a romance scam; and (4) \$50,000 to financial exploitation by a brother-in-law. Id.

¹¹ Id.

¹² See Rule 2165(b)(1)(B).

¹³ See Notice at 34086.

¹⁴ See Rule 2165(b)(1)(C).

¹⁵ See Rules 3110, 3120, 3130, 3150, and the Rule 4510 Series.

matters related to the financial exploitation of specified adults.¹⁶ With respect to associated persons who may be handling the customer's account, Rule 2165 also requires that any request for a hold be escalated to a supervisor, compliance department or legal department rather than allowing the associated person to independently place a hold.¹⁷ In addition, a member firm relying on the rule is required to develop and document training policies or programs reasonably designed to ensure that such associated persons comply with the requirements of the rule,¹⁸ as well as retain records related to compliance with the rule, which must be made readily available to FINRA upon request.¹⁹

The proposed rule change would expand upon Rule 2165 in both scope and temporal reach by: (1) expanding the scope of Rule 2165(b)(1) by permitting member firms to place a temporary hold on a securities transaction, in addition to the already-permitted hold on disbursements, where the preexisting conditions of the rule, including the member's reasonable belief of customer financial exploitation, are met;²⁰ (2) permitting firms to extend the maximum time period for any temporary hold initiated pursuant to Rule 2165(b)(1) for an additional 30 business days beyond the current maximum of 25 business days, if the firm has reported the matter to a state regulator or agency of competent jurisdiction, or a court of competent jurisdiction;²¹ and (3) requiring member firms to retain records of the reason and support for any extension of a temporary hold, including information regarding any communications with, or by, a state regulator or agency of competent jurisdiction or a court of competent jurisdiction.²² According to FINRA, the proposed rule change is designed to protect investors and the public

¹⁶ See Rule 2165(c)(1).

¹⁷ See Rule 2165(c)(2).

¹⁸ See Supplementary Material .02 to Rule 2165.

¹⁹ See Rule 2165(d).

²⁰ See proposed Rule 2165(b).

²¹ Id.

²² See proposed Rule 2165(d).

interest by strengthening the tools available to FINRA’s member firms to combat the financial exploitation of vulnerable investors, which presents the potential for significant and longstanding harm to those investors.²³

Rule 2165(b) (Temporary Hold on Disbursements or Transactions in the
Account of a Specified Adult)

With respect to placing holds on securities transactions, FINRA indicated that a hold on disbursements may be insufficient to protect certain investors from financial exploitation. In support of its proposal, FINRA pointed out that even if a temporary hold is placed on the resulting disbursement out of a customer’s account, the execution of the transaction may still subject the customer to significant, negative financial consequences.²⁴ Additionally, and as noted above, the safeguards in Rule 2165 are designed to help prevent misapplication of the rule with respect to temporary holds on disbursements, and these safeguards would apply equally to temporary holds on transactions.

Rule 2165(b)(4) (30-Day Extension of the Temporary Hold Period)

By increasing the potential maximum duration of the temporary hold, whether for disbursements or transactions, from 25 business days to 55 business days, the proposed rule

²³ In August 2019, FINRA engaged in a retrospective review to assess the effectiveness and efficiency of its rules and administrative processes designed to protect senior investors from financial exploitation, including Rule 2165. FINRA stated that information gathered during the review supported the need for additional time for firms to resolve matters arising from suspected financial exploitation, as well as extending the rule to allow firms to place securities transaction holds. See Notice at 34087.

²⁴ See Notice at 34087. For example, according to FINRA such customers may be subject to adverse tax consequences, early withdrawal penalties (such as surrender charges), the inability to regain access to a sold investment that was subsequently closed to new investors, or unauthorized trading in the customer’s account, including in inappropriately high risk or illiquid securities. Id. A “surrender charge” is a type of sales charge that must be paid if money from a variable annuity is sold or withdrawn during the “surrender period” – a set period of time that typically lasts six to eight years after the annuity is purchased. See, e.g., Commission, Office of Investor Education and Advocacy, Variable Annuity Surrender Charges (Glossary), Investor.gov website, (Aug. 11, 2021), <https://www.investor.gov/introduction-investing/investing-basics/glossary/variable-annuity-surrender-charges>.

change would provide member firms with additional time to resolve matters arising from suspected financial exploitation in instances where the firm has reported the suspected exploitation to state regulators, adult protective services (“APS”) agencies, or law enforcement.²⁵

FINRA indicated that information it gathered during the retrospective review supported the need for member firms to have additional time to resolve financial exploitation matters.²⁶ Although some retrospective review stakeholders and commenters on a FINRA regulatory notice²⁷ stated that some matters, such as activity that generally occurs as a result of a commonly-known scam, can be quickly resolved after placing a temporary hold, other matters are more complex and may require additional time.²⁸ For example, suspected financial exploitation of an elderly customer by a family member or caregiver may require additional time to resolve because of the need to interview multiple individuals, as well as to collect and review relevant documents according to FINRA. In these more complex cases, both the firm that has reported the suspected exploitation and the government or law enforcement entity investigating the conduct often need additional time to collect and share information to bring the investigation to resolution. In support of a maximum time period of 55 business days, FINRA cited to data indicating that the average duration of an investigation for matters reported to the federal National Adult Maltreatment Reporting System (NAMRS) is 52.6 days.²⁹

Proposed Rule Change

As noted above, proposed Rule 2165 would: (1) expand the current rule by permitting member firms to place a temporary hold on a securities transaction, subject to the same terms

²⁵ See Notice at 34087; 34089.

²⁶ See Notice at 34087.

²⁷ The commenters referenced in this instance are commenters on FINRA Regulatory Notice 20-34 (Oct. 2020). See Notice at 34086. FINRA stated that it considered the collective feedback from the retrospective review stakeholders and comments to the Notice 20-34 proposal in assessing Rule 2165 and the proposed amendments. See Notice at 34091.

²⁸ See Notice at 34088.

²⁹ See Notice at 34092.

and restrictions currently applicable to a temporary hold on disbursements, where there is a reasonable belief of financial exploitation,³⁰ (2) permit member firms to extend the maximum time period for any temporary hold initiated under the rule for an additional 30 business days if the firm has reported the matter to a state regulator or agency of competent jurisdiction, or a court of competent jurisdiction,³¹ and (3) require member firms to retain records of the reason and support for any extension of any temporary hold, including information regarding any communications with, or by, a state regulator or agency of competent jurisdiction or a court of competent jurisdiction.³²

Rule 2165(b) (Temporary Hold on Disbursements or Transactions in the Account of a Specified Adult)

Rule 2165 currently permits temporary holds to be placed on disbursements of funds or securities when the firm has a reasonable belief that the customer is being financially exploited. Although this serves to stop funds or securities from leaving a customer's account, the rule does not permit a firm to place a hold on a securities transaction where the same financial exploitation is suspected.³³ Accordingly, FINRA is proposing to amend Rule 2165 to permit firms to place a temporary hold on securities transactions when the firm has a reasonable belief that the customer is being financially exploited.³⁴ In accordance with the Rule's safe harbor approach for holds on

³⁰ See proposed Rule 2165(b).

³¹ Id.

³² See proposed Rule 2165(d).

³³ For example, FINRA stated that Rule 2165 currently would not apply to a customer's order to sell his shares of a stock. However, FINRA elaborated that if a customer requested that the proceeds of a sale of shares of a stock be disbursed out of his account at the member firm, then the rule could apply to the disbursement of the proceeds where the customer is a "specified adult" and there is reasonable belief of financial exploitation. See Notice at 34087 at n.33.

³⁴ See proposed Rule 2165(b).

disbursements,³⁵ the proposed rule change would permit, but not require, firms to place a hold on transactions in these circumstances.

Rule 2165(b)(4) (30-Day Extension of the Temporary Hold Period); Rule 2165(d) (Record Retention)

Rule 2165 currently allows a member firm to place a temporary disbursement hold on a specified adult customer's account for up to 15 business days if the specified conditions required by the rule are satisfied, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction, or a court of competent jurisdiction.³⁶ The member firm may extend that hold for an additional 10 business days, for a maximum of 25 business days total, if the member firm's internal review of the facts and circumstances supports its reasonable belief that the financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted, unless otherwise terminated or extended by a state regulator or agency of competent jurisdiction, or a court of competent jurisdiction.³⁷ Under FINRA's proposal, these hold periods would also apply to transactions held under the same conditions described above.

FINRA is proposing to amend Rule 2165 to permit firms to extend any temporary hold under the rule for an additional 30 business days if the member firm has reported the matter to a state regulator or agency of competent jurisdiction, or a court of competent jurisdiction.³⁸ Thus,

³⁵ FINRA stated that Rule 2165 provides member firms and their associated persons with a safe harbor from FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2150 (Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts) and 11870 (Customer Account Transfer Contracts) when member firms exercise discretion in placing temporary holds on disbursements of funds or securities from the accounts of specified adults consistent with the requirements of Rule 2165. See Notice at 34086.

³⁶ See Rule 2165(b)(2).

³⁷ See Rule 2165(b)(3).

³⁸ FINRA stated that the 30 business day hold period in proposed Rule 2165(b)(4) would be in addition to the 15 business day hold in Rule 2165(b)(2) and the 10 business day hold in Rule 2165(b)(3). See Notice at 34087 n.31.

firms would be able to extend a transaction or disbursement hold up to a maximum of 55 business days only in instances where they have externally reported the suspicious conduct.

In addition, Rule 2165(d) currently requires member firms to retain records related to compliance with the rule, which must be readily available to FINRA upon request. To evidence compliance with Rule 2165 in placing or extending a temporary hold, FINRA is proposing to amend Rule 2165(d) to require that a member firm retain records of the reason and support for any extension of a temporary hold, including information regarding any communications with, or by, a state regulator or agency of competent jurisdiction or a court of competent jurisdiction.³⁹

III. Proceedings to Determine Whether to Approve or Disapprove File Number SR-FINRA-2021-016 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings to further consider the proposed rule change and the issues raised by commenters. Specifically, the Commission is providing notice of the following grounds for possible disapproval under consideration:

- Whether FINRA has demonstrated how its proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act, which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.⁴⁰

Under the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the [Exchange Act] and the rules and regulations issued thereunder...is on the [SRO] that proposed the rule change."⁴¹ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative

³⁹ See proposed Rule 2165(d)(6).

⁴⁰ 15 U.S.C. 78o-3(b)(6).

⁴¹ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

Commission finding,⁴² and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations issued thereunder.⁴³

For the reasons discussed above, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to allow for additional consideration of the issues raised by the proposed rule change as it determines whether the proposed rule change should be approved or disapproved.⁴⁴ Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change.

IV. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with the Exchange Act and the rules thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.⁴⁵

⁴² See id.

⁴³ See id.

⁴⁴ 15 U.S.C. 78s(b)(2)(B).

⁴⁵ Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 15 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 21 days from publication in the Federal Register]. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2021-016 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR- FINRA-2021-016. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-FINRA-2021-016 and should be submitted on or before [insert date 15 days from publication in the Federal Register]. If comments are received, any rebuttal comments should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁶

J. Matthew DeLesDernier,
Assistant Secretary.

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⁴⁶ 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).